GEO
Guyana Economic Opportunities

GMA's Position Paper
for the
Reform of the Consumption Tax

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GMA'S POSITION PAPER ON CONSUMPTION TAX REFORM

INTRODUCTION

The Guyana Manufacturers Association (GMA) is pleased to submit this Proposal to the Government for the reform of the existing Consumption Tax system in the following respects:

1) replacement of existing rates by an across-the-board 15% tax or duty on raw materials and inputs to manufacturing on locally produced manufactured goods;
2) retention of current rates for alcoholic beverages, tobacco and tobacco products, petroleum and flour pending a separate study into the C-tax effect on these sectors; and
3) retention of existing exemptions on inputs available to manufacturers.

Consumption Tax has always been considered by importers and manufacturers in particular to be a burden that reduces their competitiveness. Over the years the GMA has made consistent efforts to represent manufacturers on this issue while successive governments have responded by reducing overall C-tax rates and reducing the number of rates. However, the rates of the tax on certain types of businesses have not been reduced with grave implications for a number of them including outright closure. Aware of the continuing difficulties facing those businesses and as a result of representations it continues to receive, the GMA, in its Budget submission for the year 2000, had requested an across-the-board 10% tax or duty on raw materials and inputs to manufacturing as well as the elimination of duty free concessions on inputs to manufacturing.

Concerned about any reductions in revenues which significant lowering of the rates of C-Tax regime could bring about, the Government of Guyana requested the submission of a Paper not only to make the case for the reduction, but also to demonstrate that such a step would not have a negative financial impact. The GMA approached the USAID-funded GEO Project for assistance and the GEO Project commissioned a study to examine and make recommendations on the proposal. This Paper arises out of that Study.

Having reviewed the draft of the Report, the GMA has revised its position and based on the findings of the Study is convinced that the best option is for an across-the-board 15% tax. We believe that this option will allow the sector to become more competitive while meeting the revenue concerns of the Government. It will also make evasion less attractive while reducing distortions, introducing administrative simplicity and widening the tax base.

The Study concluded that "should the Government accept the GMA’s proposal, its revenues would increase, the system would become more efficient and much less Ministerial time would be consumed dealing with requests for waivers and exemptions."

The findings and recommendations of this Study are consistent with those arising from similar studies carried out since the launch of the Economic Recovery Programme including those done by F.W.Crittle in 1991 and Jack M.Mintz in 1993 as well as the National Development Strategy (2000)

THE MANUFACTURING SECTOR

For a number of reasons, the manufacturing sector in Guyana has remained fairly small. The sector has had to survive a regime of high taxes, import controls, declining rate of the Guyana currency, uncompetitive (high) utilities cost, and a small domestic market, often competing with smuggled goods. To compensate for these, the sector has enjoyed extensive and expensive protection provided by successive Governments mainly in the form of tariffs and tax incentives.

Despite its poor performance thus far, the sector can become competitive in the production and export of manufactured products utilising its rich, commercially exploitable natural resources. For this however the distortions and impediments need to be removed with the establishment of a tax and regulatory framework and the necessary infrastructure to promote competitiveness.

THE TAX SYSTEM

Guyana has always been rated as one of the highest taxed countries in the world[1]. While the average tax burden of the countries of Latin America for the years 1991-1995 was 14.1% of GDP and that of Asia was 16.8%, Guyana's was a staggering 35%. While the ratio since 1995 has been falling, it is still extremely high even without the inclusion of social security taxes. The reasons for this are two-fold:

1) Even as the country has sought to narrow its fiscal deficit, the Government has had to invest heavily in physical and social infrastructure to compensate for the substantial deterioration over several years. Accordingly, the country has to collect increasing revenues to meet these additional expenditures by the Government. Any attempt therefore to examine revenues cannot be separated from consideration of the expenditure side of the Budget.

2) The tax base of the country is extremely narrow and there is a widely held view that many sectors and entities do not contribute fairly to the tax revenues of the country. With this narrow base, economic inefficiency, inequity and tax evasion are prevalent and successive studies and pronouncements by consultants, economists and politicians have emphasised the need for substantial tax reform designed among other things to widen the tax base, reduce rates of taxes and remove the deficiencies associated with the current system.

One of the cardinal features of the tax system requires that there be no distortion in the allocation of resources and that exemptions be either abolished or minimised. While this is recognised in any discussion on the fiscal system, over the past few years the extent of exemptions and remissions appears to have increased. The current system of discretionary exemptions provides little in the way of guidelines or criteria other than it be deemed "fair and equitable" by the Minister. As such access is uncertain and the system cumbersome and opaque.

[1] IDB, *Economic and Social Progress in Latin America* (1996): p128

CONSUMPTION TAX

C-Tax is a tax payable on chargeable goods imported into Guyana or manufactured or acquired here, except certain services and chargeable goods imported or acquired as materials for and used as such by a registered manufacturer. “Chargeable goods” are any goods specified by Order by the Minister. However registered manufacturers are exempted from C-Tax on all directly imported inputs and all domestically produced inputs purchased from registered manufacturers. Despite this legal exemption, most manufacturers have indicated that they pay C-Tax on their inputs.

The most recent statistics indicate that there are only two hundred and sixty nine (269) registered manufacturers which suggests that there may be a large number of unregistered persons who have chosen to be outside the C-tax net despite the exemption to which the law entitles them. It seems that one reason for non-compliance is that the enforcement mechanisms are considered weak and therefore the probability for detection is low or the penalties not of a sufficient deterrent.

The entire tax system in Guyana including the C-Tax, is characterised by remissions and exemptions which distort allocative efficiency, lack transparency, lead to considerable uncertainty, and because of the narrowing of the tax base require high rates which in turn lead to evasion and calls for further exemptions.

Currently only Guyana and Antigua of Caricom countries have C-Tax as all the major countries have replaced it with Value Added Tax (VAT). It is worth noting however, that Antigua does not charge C-Tax on domestic produce, in breach of Article 24 of Protocol IV of Caricom. Empirical evidence suggests and indeed the IMF has recommended the introduction of VAT in Guyana. Not everyone however, shares the view that Guyana is in a position for the immediate implementation of VAT. There are very severe data limitations which inhibit adequate analysis and revenue impact considerations which are necessary in such a substantial exercise. There is also the view that tax reform in which the entire tax system is reviewed for relevance and appropriateness should be undertaken, as was done in some of the Caricom countries, prior to a fundamental change in the tax system. The GMA is convinced that the case for significant C-Tax reform is even greater than in 1991 when the Crittle Report showed the benefits of simplifying the system through a flat rate of C-tax or in November 1993 when Jack Mintz submitted his *Tax Reform Proposals for Guyana.*

The NDS also recommends a reduction of the C-tax burden by introducing a lower uniform rate with special higher rates remaining on certain classes of products. The NDS is conscious of the revenue concerns of the government and its recommendations protect government's revenue targets while reducing the burden on consumers.

The substantial contribution of C-Tax to total revenue explains Government's caution in responding to any request for an across-the-board decrease of rates of C-Tax. In 1999 approximately G$12Bn representing 32% of total tax revenue was collected as consumption taxes of which $8.6Bn is derived from imports and $3.1Bn from domestic manufacturers.

The top five payers of domestic C-Tax are Banks DIH Limited, Demerara Distillers Limited, National Milling Company, Torginol Guyana Limited and Edward B. Beharry & Company Limited. It is estimated that in total, these five companies account for approximately 92% of the Consumption Tax received by the Government in1999.

Using 1999 C-tax collections, at least G$2,669Mn or 86.1% of domestic collections will not be affected by the changes proposed by the GMA. Indeed as Appendix 2 indicates, if the revised proposal was accepted in its entirety there will be a net increase of G$254Mn in revenues. On the other hand if existing exemptions and zero rates were removed, and if steps were taken to reduce remissions and strengthen enforcement the potential gain would be $404Mn.

The GMA believes that special rates need to be maintained on certain products such as alcoholic beverages, petrol and tobacco products and that the rate reductions should be applied only to other manufactured products. In accordance with Article 24 of Protocol IV, any reduction will also apply to Caricom imports. Some manufacturers have expressed the view that this could lead to a flood of Caricom goods into Guyana and the loss of the competitive advantage which domestic manufacturers assume by very creative costing and pricing practices. On the other hand the lower rates will make smuggling and evasion less attractive and collections will increase.

RECOMMENDATIONS FROM THE STUDY

The options available to the government range from accepting the GMA's proposal to its rejection with several intervening possibilities. The Study offered three principal options within these two extremes and recognises that there can be a number of permutations of these particularly principal option 3.

The Study noted the unavailability of information relevant to the engagement and as a result relied on information from a number of sources making such assumptions as considered appropriate. The implementation of the recommendations in the Study will bring immediate relief to a number of operators in the domestic manufacturing sector including printing, furniture, paint, confectionery, fruit juices and jams and jellies. This group constitutes a significant proportion of the country's manufacturing base and there is no doubt that the measure will be widely welcome. The Study's recommendations are set out in Appendix 1 to this letter.

It recommended however, that changes of a more fundamental nature be made on the basis of a comprehensive tax reform process in which all interested parties have the opportunity to participate:

1. That the Reports by Welling (*Report on the Establishment of a New Consumption Tax Control Programme*), Crittle (*Review of the Application and Administration of Consumption Tax in Guyana*) and the IMF (*Guyana: Toward a Medium Term Strategy for Reforming Tax Policy and Administration*) be referred to a Select Committee for review and recommendations.

2. The basis of valuation for purposes of C-tax, particularly in the case of manufacturer/ distributor needs to be clarified.

3. The C-Tax Act and Schedule should be consolidated and simplified.

4. A public information programme should be designed to encourage compliance with the law.

5. There should be established a Statistical Unit in the GRA to ensure that data are collected and maintained in a manner useful for planning purposes.
6. There should be established in the Ministry of Finance, a Tax Policy Unit charged with the responsibility for considering and recommending various options available within the fiscal system.
7. Guidelines subject to the approval of Parliament should be established for the granting of remissions and waivers.
8. Certain categories of items that enjoy remission should be reviewed and if necessary investigated.
9. A census of manufacturers should be carried out to bring all manufacturers on the Register.
10. The existing threshold for exemption needs to be reviewed and increased.

Acceptance of this will render easier the introduction of VAT in the near future.

REVENUE IMPLICATIONS

Subject to the assumptions made by the Consultants, each of the options identified results in increased revenues to the Government. The option with the highest estimated net revenue gain ($404Mn) is a flat rate of 15% and removal of exemptions and zero rates now enjoyed by manufacturers. If the exemptions and zero rates are retained, the net gain is $254Mn. The option with the least estimated gain is the flat rate of 10% with the retention of existing exemptions and zero rates enjoyed by manufacturers.

Each of the options anticipate that with lower rates, better enforcement and increased voluntary compliance, the revenue will increase by 10% over collections from the non-alcoholic and flour manufacturers. They also anticipate that with lower rates, and the decision to remove distortions in the allocation of resources, the government will reduce by 5% the value of remissions currently given.

The Study for the reason of tax efficiency, resource allocation, reduction of political intervention in the tax system and the removal of uncertainty supported Option 3 II) i.e. a flat rate of 15% and the removal of zero rates and exemptions now available to manufacturers or Option 3 V) i.e. a flat rate of 15% while retaining zero rates and exemptions **(The GMA's revised proposal)**.

It would be useful to note the following option recommended in the Report on Consumption Tax prepared F. J. Crittle:

"To eliminate non-oil duty exemptions on imports and utilse the increased government revenues to finance a reduction in the rate of consumption tax to 5%. Such a policy would enjoy all the advantages of choice two i.e. administrative simplicity, reduced distortion, of production and consumption choices, reduced inducement to evade and abuse the system, and revenue and price neutrality. Further resource allocation distortions induced by the exemption policy would be significantly reduced with a consequent increase in consumer welfare. Then benefits of such a policy choice would be felt by all sectors of the community whilst the costs, in the short term, would be borne solely by the manufacturing sector by way of reduced implicit assistance from the government and thus reduced margins. In the longer term industry would adjust by implementing long overdue improvements in productivity in response to the more rational set of price signals."

While the benefit of tax reductions should not be underestimated, the challenges facing the manufacturing sector will not be overcome by mere tax changes. Successful manufacturing requires a stable macro-economic environment which fosters allocation efficiency, removes uncertainty and tax discrimination and low rates of tax. It is the view of this Report that annual tinkering has not produced the desired results of simplicity, fairness, efficiency and revenue. As much as ever, the economic conditions demand decisive action for the good of the economy as a whole even though there will be some losers.

CONCLUSION

The GMA will be pleased for the opportunity to meet with government representatives to provide any further information or explanations considered necessary.

APPENDIX 1: OPTIONS OFFERED BY THE CONSULTANT

1. Ignore the original and revised request of the GMA and maintain the status quo. This would leave in place the several differential rates, the attraction and scope for evasion and leaving the Government open to criticism that it is unresponsive to the manufacturing sector.

2. Move towards a fundamental restructuring of the entire system of taxation leading almost inevitably to the introduction of VAT. However, for reasons explained in this Paper the successful implementation of VAT will take about three years even if no impact study is undertaken. The GMA is also of the view that restructuring should only occur after a detailed, comprehensive study of the structure of the economy and current taxes has been undertaken with the full participation of all stakeholders.

3. While manufacturers are not opposed to VAT in principle, they are in favour of immediate steps to reform C-Tax, removing some of the more negative features of the current system, offer some relief to those manufacturers most affected by the current high rates and pave the way for VAT. Among the options if the government favourably considers the request are:

   I. accept the GMA's original proposal and like Antigua, apply the reduced rates to domestic operations only. This however is in breach of Article 24 of the Protocol amending the Caricom Treaty which forbids discrimination.

   II. accept the GMA’s original proposal for goods manufactured in Guyana and corresponding imports from Caricom countries with an immediate or phased withdrawal of existing exemptions and zero rates by making all inputs and imports subject to the 10%.

   Both these measures will produce increased revenues while removing the distortions inherent in the current system, reduce remissions and make the entire process more transparent. This is likely to meet with objections from some manufacturers who claim that they will lose their competitiveness. Government should be willing to consider temporary relief within a defined, limited period to allow those companies which prove that the change will seriously harm their business.

   III. accept the GMA’s original proposal subject to the following:

      a. No discrimination which means that the lowering of the rate will also apply to Caricom imports;
      b. Retain existing zero rates for inputs into manufacturing;
      c. Reduce the frequency and level of discretionary exemptions.

   This will however still have the potential for distortion of resource allocation and continuing calls for zero rates.

IV. modify III above by reducing the rate applicable to domestic manufacturers and domestic services to 15% rather than the proposed 10%. A 15% rate not only guarantees increased revenues to the government but is also likely to be the rate which will apply under VAT.

V. As a variant of IV introduce a flat rate of 15% while retaining the current zero rates and exemptions (the GMA's revised proposal).